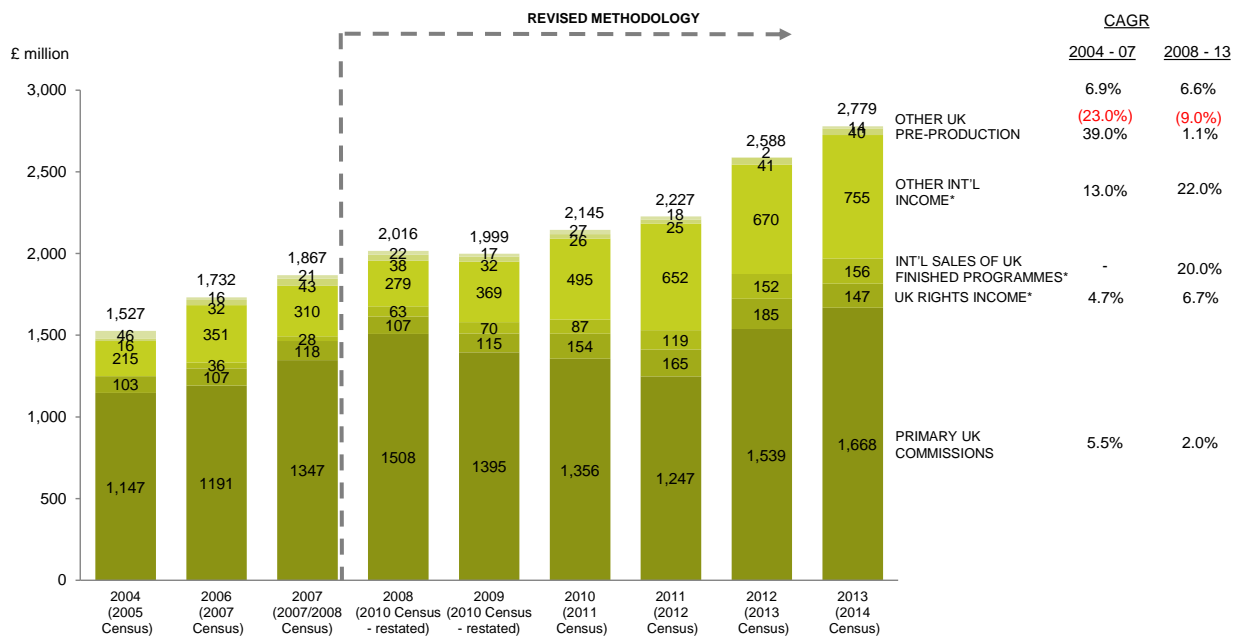


1.4 The Success Of The UK Independent Production Sector

1.4.1 A Growing and Increasingly International Sector

The UK independent production sector has been in the vanguard of the increased globalisation of the TV market and the increasing importance of international trade flows. The sector as measured by the annual Pact Census has grown considerably over the past ten years¹, following intervention on the Terms of Trade with PSB broadcasters in 2003 and the expanded scope to supply the BBC under the WoCC since 2006. Between 2008 and 2013 the sector has grown by 6.6 per cent a year, despite the global downturn between 2008 and 2011². Figure 1 shows the growth story since 2004 for total independent sector income by main category.

Figure 1: Independent producer TV-related revenues, 2004 to 2013



*Definitions: 'Other international income' - revenue from companies overseas operations and any primary commissions received from non-UK broadcasters; 'Int'l sales of UK finished programmes' - sales of first run UK programming sold as finished product abroad; 'UK rights income' - UK secondary sales, publishing, formats, DVD sales etc.
Source: Pact census, Oliver & Ohlbaum analysis

The UK independent sector was able to respond to tougher economic conditions in their home TV commissioning market from 2008– compounded by the ending of some PSB programming obligations on ITV – by growing their global rights business, and above all, growing the level of international commissioning of original UK sourced IP. According to the Pact census, UK commission income fell by almost 17 per cent from £1.5 billion in 2008 to £1.25 billion in 2011, but over the same period UK independent producers grew their income from international commissions of programmes based on UK IP and/or provided by UK based production divisions from £279 million in 2008 to £652 million in 2011 – or 33 per cent per annum. Faced with tougher conditions in the UK they took market share across the globe despite the world’s longest and deepest recession since the 1930s.

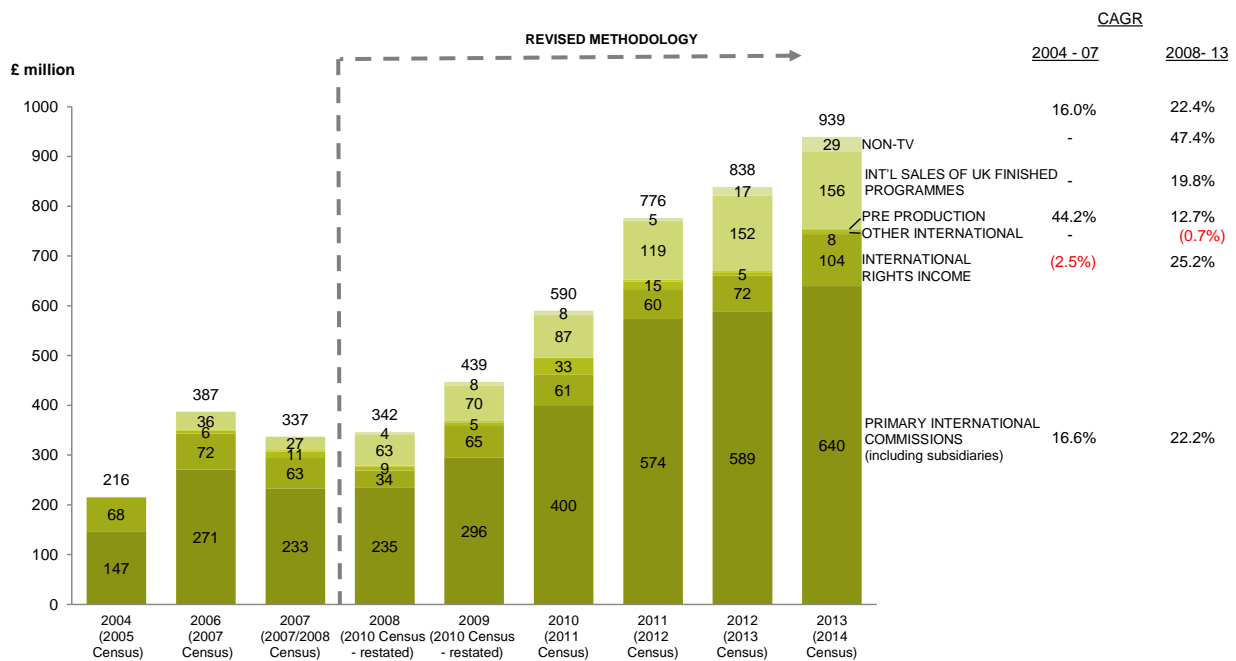
¹ The annual Pactcensus excludes ITV studios and BBC In house production, but does include producers owned or with significant links with UK broadcasters such as Fremantlemedia up to 2010, and Shine since 2011, Carnival etc. since 2008, and in the future All3Media in 2014. The implications of this trend to cross ownership – which removes the indies qualifying status and terms of trade protection for the company is discussed in more detail in later sections.

²² Pact Census 2014

A recent survey of the top 100 formatted commission programme titles in European over the last 5 years both by hours and estimated airtime value (audience multiplied by advertising CPMs) had 40 of them sourced from original UK IP, by far the largest source of supply) and within that 32 were original developed by UK indies, 5 from ITV Studios and just 3 from BBC Worldwide.³

As **Error! Reference source not found.**Figure 2 shows, international sales of ready-made UK programmes grew by almost 20 per cent a year over the period, while sales of non-domestic rights in their international commissions grew from £34m in 2008 to £104m in 2013, a growth rate of 25 per cent per annum⁴.

Figure 2: International revenues earned by independent producers, 2004 to 2013



Source: PACT census, Oliver & Ohlbaum analysis

1.4.2. Producing Programming Across All Genres

The independent sector⁵ now provides over 60 per cent of all non-news commissioned TV hours on peak time PSB networks in the UK; the breakdowns by channel and genre are presented in Figure 3 (the equivalent percentage of non-peak commissions made by independent producers is 52 per cent)⁶. Although independent commissioned output in peak time is dominated by drama, entertainment, lifestyle and factual entertainment, the sector also produces 71 hours of peak time current affairs, 800 hours of documentaries and general factual programming and about 27 hours of arts, religion, education and consumer programming.⁷ The sector has already proven it can provide a

³ TV Formats in Europe (2014), ETS, Madigan Cluff and Digital TV Research. We will come on to the importance of this relative performance for the “TV content multiplier” in later sections

⁴ The rights income to producers is net of distributor costs and commissions.

⁵ Independents covers qualifying and non qualifying independents and excludes BBC in house and ITV Studios output but includes independent producers owned or soon to be owned by international broadcast groups.

⁶ In this analysis and the following Figures we take PSB networks to mean BBC1, BBC2, ITV1, Channel 4 and Channel 5; these are major UK channels with the most significant public service obligations on them. Note that the BBC definition of network includes their spin-off channels (BBC3, BBC4, Cbeebies, CBBC).

⁷ We will come on to the relatively low levels of indie commissioning across the more overtly PSB genres and whether this is due to demand or supply conditions later in this report.

full range of genres including the more public service type output (independents often producing episodes of BBC in house led strands such as *Horizon*, *Imagine*, and *Panorama*). The proportion of peak time output supply varies considerably by channel, however, with independents providing about 40 per cent of BBC1 and 2 peak time commissions, 44 per cent of ITV's but around 95 per cent of Channel 4 and Channel 5.

While independent producer share of lower budget non peak output tends to be lower across all PSB networks in aggregate, this does not apply to the BBC networks, which alone among the PSB network organisations use independents proportionately more in non peak hours than peak hours.

Independent producer share of spin off network channel original commissioning (BBC3, BBC4, ITV2, E4 etc.) and independent multichannel operators tends to be higher than for the PSB networks. O&O has estimated that independent producers provide about 60 per cent of all commissioned programmes by hours and value for spin-off channels and around 85 per cent of non news and sport commissions for multichannel operators. Figure 4 below shows the spending by UK independent multichannel operators on new UK content since 2011 by source (although this does include news and sports production, which tends to be made in-house by pay platforms).⁸ Growth over the period has been driven mostly by pay TV's strategic need to drive penetration and average revenue per subscriber by going beyond its core live exclusive sports, early windows on movies and acquired TV material – much of it from the US – to especially commissioned UK material. This has been led by UK or coproduced drama and comedy on the Sky channels but also covers channel groups such as UKTV, MTV and Discovery and genres such as entertainment, factual entertainment, natural history and arts.

⁸ COBA Census 2014, (by O&O)

Figure 3: Total commissioned hours by PSB networks from indies, by genre, peak time, 2013

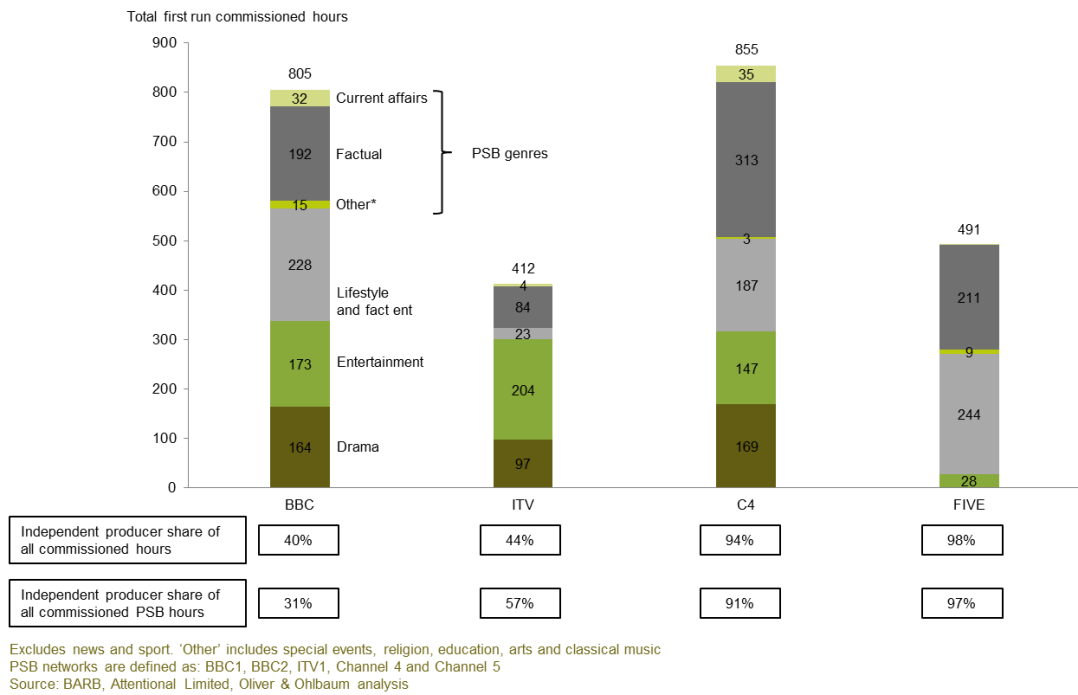
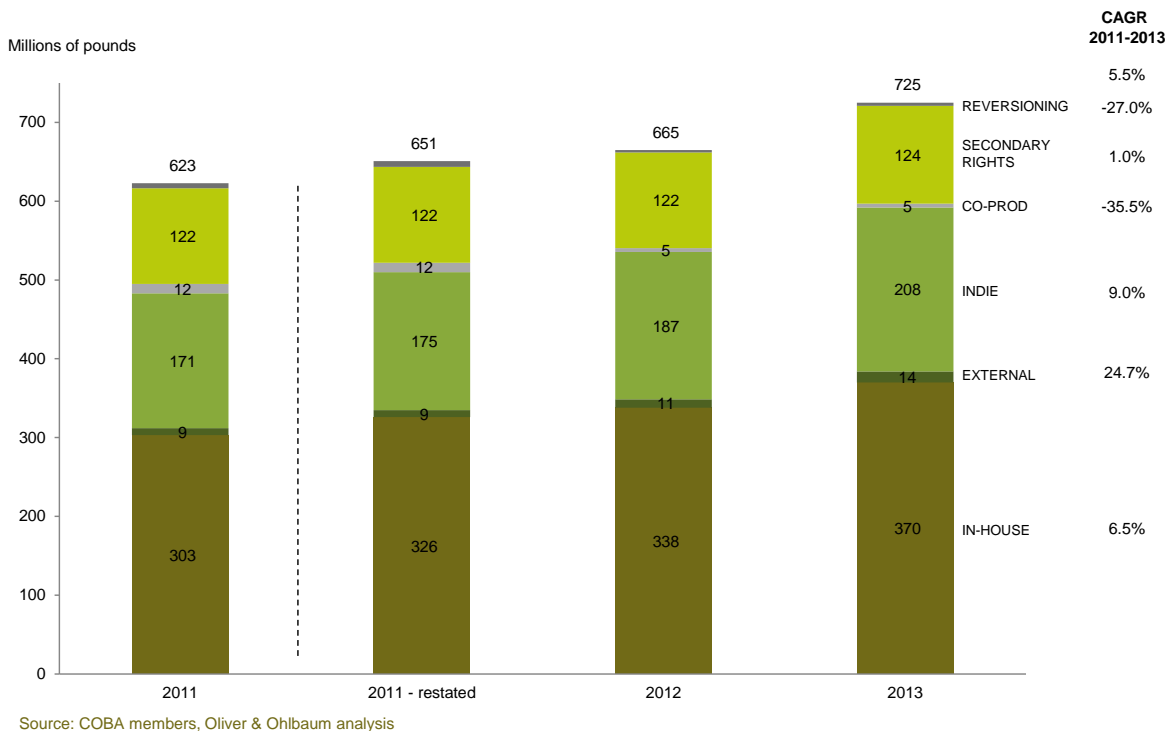


Figure 4: UK independent thematic channel investment in content, 2011 to 2013⁹

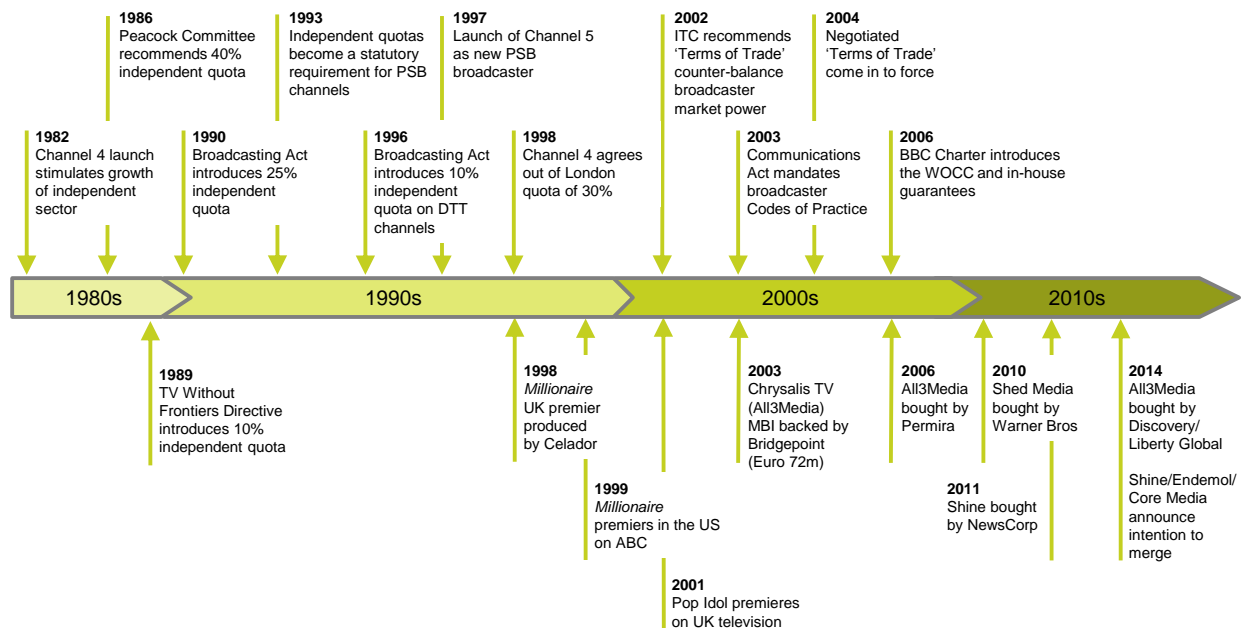


⁹ Numbers restated for 2011 due to changed methodology for estimating total market size from census sample when O&O took over census from Deloitte.

1.4.3. Benefiting From Targeted and Timely Policy Intervention

The success of the UK independent sector has not been an accident. It has come about through a succession of effective policy interventions aimed at breaking down the UK's highly vertically integrated and traditionally inflexible UK production sector, which back in 1980 provided almost 100 per cent of all new programming through the BBC and ITV regional licensees internal production divisions. Figure 5 maps out the main interventions and sector events from 1980 to 2006 (when the BBC decided to open up to 50 per cent of its output to outside suppliers) and then to 2014 and the recent super indie purchases.

Figure 5: Timeline of regulatory and corporate indie events in the UK content market, 1982 to 2014



Source: ITC, Ofcom, Pact, European Commission, Oliver & Ohlbaum analysis

1.4.4. Still Highly Competitive Despite Recent Consolidation

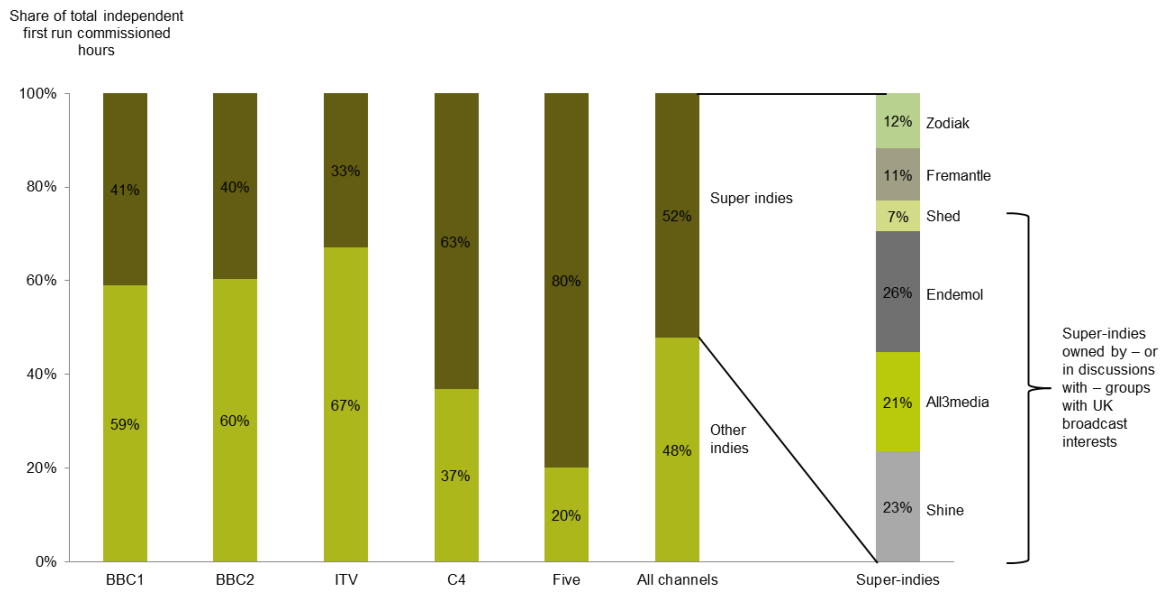
The last 10 years has seen the emergence of the so called super-indies, through acquisitions and organic growth, as owners sought the critical mass to (1) grow globally, (2) co-fund IP development, (3) diversify away from over dependence on individual title performance, and (4) build their own support and exploitation functions such as programme sales and rights management. The UK spawned four of its own home grown super-indies – All3media, Tinopolis, Shed and Shine – and provided the most important IP generating component of three international super-indies – Fremantlemedia, Zodiak and Endemol.

Despite consolidation, these super-indies account for just about half (52 per cent) of all independent commissions by the PSB networks, and only Endemol, Shine and All3media have a share greater than 10 per cent of all independent commissions from PSB networks. In addition the super-indie shares for ITV and the BBC have to be seen against the background of ITV sourcing about half of all its programming from ITV Studios and the BBC sourcing just over half of all its output hours from BBC in-house. Figure 6 shows the indie supply market shares of super-indies by PSB channel in 2013, and then breaks down the shares of each of the super-indies. Figure 7 shows the hours of output by super-indies across the PSB networks in 2013, and shows that despite consolidation in the sector, the four super-indies who are owned – or may soon be acquired – by groups with UK broadcast interests

have not significantly grown their share of PSB network commissions organically compared with 2008.¹⁰

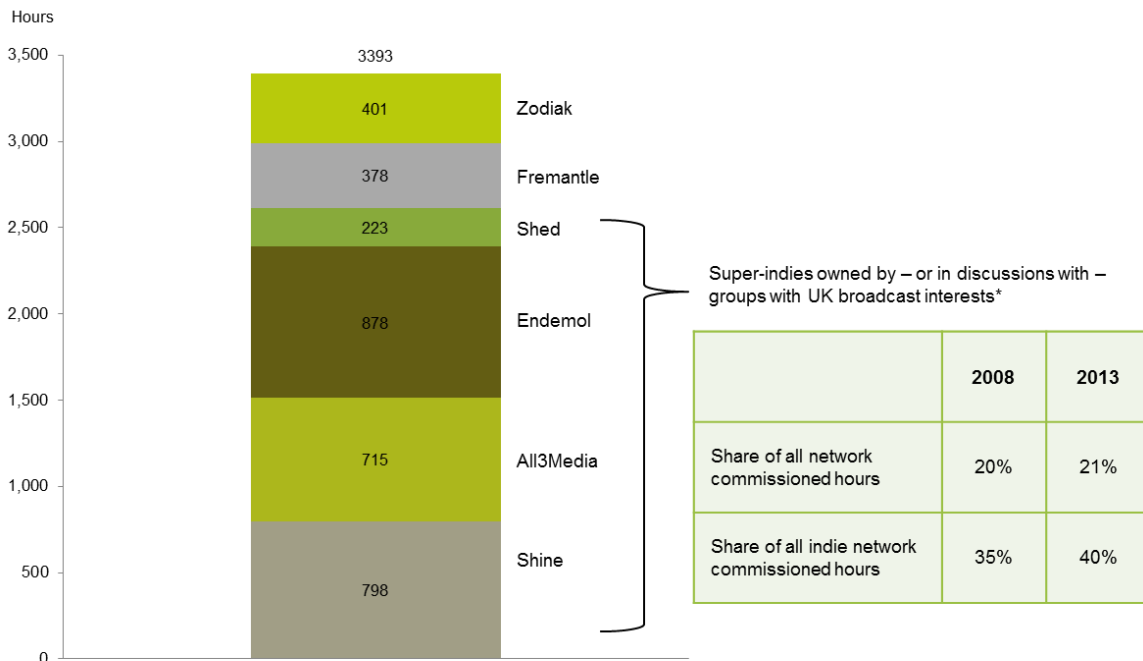
¹⁰ The 2008 share number is that for the companies which were in the group in 2013. This provides a like-for-like comparison which strips out the impact of acquisitions and measures whether the companies now part of a super-indie have grown share

Figure 6: Proportion of hours commissioned by PSB networks from super-indies and other independent producers, all day, 2013



Excludes news and sport
 PSB networks are defined as: BBC1, BBC2, ITV1, Channel 4 and Channel 5
 Source: BARB, Attentional Limited, Oliver & Ohlbaum analysis

Figure 7: PSB network commissioned hours from super-indies, all day, 2013



Endemol is in talks about a merger with Core Media Group and Shine
 Excludes news and sport
 PSB networks are defined as: BBC1, BBC2, ITV1, Channel 4 and Channel 5
 Source: BARB, Attentional Limited, Oliver & Ohlbaum analysis

1.4.5. Cross Ownership by International Broadcasters Eliminates the Regulatory Advantages Enjoyed by an Independent Producer

In the last 5 years there has been a growing tendency for international media groups (mainly from the USA) to acquire UK based indies and super-indies, such as Sony (Celador), NBCUniversal/Comcast (Carnival), Discovery Networks/Liberty Global (Betty, All3Media), 21st Century Fox (Shine) and Warner Brothers TV (Shed).

This trend is a direct result of the UK based indie community's ability to generate globally successful IP and retain the rights in this IP, and the need for international media groups to get access to that content pipeline.

However, each of the international groups that have bought into the UK indie sector also have UK channel broadcast licences which means that the indies they take over (1) do not come under PSB indie terms of trade rules and must negotiate their own terms (as All3Media has just done with Channel 4)¹¹, and (2) their loss of qualifying independent status means their output no longer counts towards the independent quotas. Figure 8 shows the UK broadcast assets owned by many of the overseas companies buying into the UK indie sector. These companies will be losing their qualifying independent status as a result, which means that are not protected by terms of trade intervention nor do they qualify for the statutory quotas¹².

Figure 8: Indie Ownership and Cross Ownership of UK Broadcasters

Producer	Share of PSB network commission hours (2013)*	Ownership		UK channels of owners	
		Beginning 2013	End 2014		
All3Media	5.7%	Permira	Discovery/Liberty Global	Discovery Channel, Animal Planet, Dmax, TLC, etc	
Endemol	7.0%	Apollo Investors, Centrebridge Investors, Mediaset, Cyrté, Goldman Sachs	21 st Century Fox?	Fox Fox News	Sky Atlantic Sky One
FremantleMedia	3.0%	RTL Group	Unchanged	None	
NBCU International	0.3%	Comcast	Unchanged	SyFy The Universal Channel	
Shed Media	1.8%	Warner Bros (80%)	Warner Bros (100%)	Cartoon Network Turner Classic Movies	
Shine	6.4%	21 st Century Fox	Unchanged	Fox Fox News	Sky Atlantic Sky One
Sony TV International	0.5%	Sony	Unchanged	Sony Channel Chart Music Company (acq. 2014)	
Tinopolis	1.7%	Management, Vitruvian Partners	Unchanged	None	
Zodiak	3.2%	De Agostini	Unchanged	None	

Excludes news and sport
 PSB networks are defined as: BBC1, BBC2, ITV1, Channel 4 and Channel 5
 Sources: Broadcast Indie Survey 2014, Company websites, BARB, Attentional Limited, Oliver & Ohlbaum analysis

¹¹ It is at the discretion of each PSB whether or not they give terms of trade to non-qualifying indies, and while some have done so (BBC and ITV), others, such as Channel 4, do not.

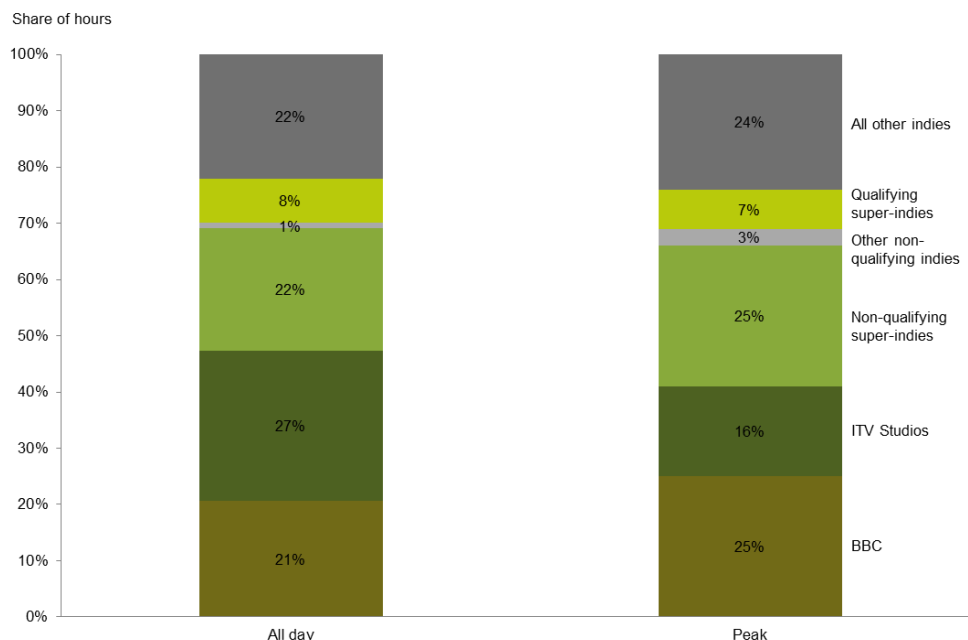
¹² The Broadcasting (Independent Productions) Order 1991 defines independent producers as those not controlled by a broadcaster or broadcasters; control is defined as a 15% shareholding or greater (later increased to 25% or an aggregate shareholding of 50% if two or more broadcasters were involved) to prevent broadcasters circumventing quotas via acquisition or spinning off in-house production while retaining a majority stake.

1.4.6. Buying is Still More Concentrated than Supply and the Combination of High Buying and Supply Market Shares is Still Limited to the BBC and ITV plc

With no independent producer making up much more than 15 per cent of the output of any channel, but with the PSBs accounting for between 10 and 40 per cent of each producers UK commission income, and more importantly, a large share of any future new IP development, UK PSB broadcasters are in a strong position when commissioning these broadcaster-linked producers to secure additional rights to UK primary licenses in return for fully or largely fully funding the original commission – as they are entitled to do outside indie terms of trade.

While non-qualifying indies now account for 24 per cent of all network output on the five main channels and 28 per cent of the peak time output, this is still less than the qualifying indies – 28 per cent and 31 per cent respectively, and far less than the two large in house operations – ITV Studios and BBC – combined, at 48 per cent and 41 per cent respectively – as shown in Figure 9.

Figure 9: Share of PSB Network Hours in 2013 By Producer Status by End of 2014 ¹³



Source: Attentional, Oliver & Ohlbaum analysis

Furthermore, even though non-qualifying super-indies do now in combination account for about a quarter of the supply market, their owners account for much smaller proportions of overall commission spend and audience viewing in the UK than either ITV or the BBC. While the BBC accounts for about one third of all viewing and 38 per cent of spend, and ITV about 23 per cent of viewing and 23 per cent of spend, the largest super indie group at the end of 2014 (likely to be the Shine/Endemol/Core grouping and Love Productions – all controlled to some degree by 21st Century Fox) only has about 9 per cent of viewing, and an estimated 10 per cent of all commission spend. All the other broadcaster owned super indie groups have audience shares and spending shares well below the 5 per cent level.¹⁴

The 2002 initial review¹⁵ of the competitive structure of UK programme supply market commissioned by the ITC (the predecessor regulator to Ofcom) which led to the Code of Conduct initiative and terms

¹³ This is based in the producer’s likely status by end of 2014

¹⁴ Estimates of share of commission spend sourced from broadcaster annual reports and presentations, Ofcom reports and O&O database of programme spending

¹⁵ The ITC Report into “The Supply of Programmes to the UK Television Market” – November 2002

of trade intervention highlighted the combination of high demand and supply shares as the most potentially damaging structural feature for stand-alone independent producers – leaving them vulnerable to a price and rights squeeze from vertically integrated and powerful buyers.

It is a combined high share of spend and supply that can truly distort the market, by giving the buyer the leverage to both limit the market for an independent supplier, and then, by favouring its own large supplier, to restrict rival broadcasters ability to compete by denying them access to an important slice of the overall supply of talent and rights. Vertically integrated producer broadcasters with a high share of both commissioning and programme supply have both the means and the incentive to squeeze the rest of the market, those with just a high share of spend have less means and less incentive – although they still have both – to squeeze the indie sector.

Around 2000 to 2002, this “vertical squeeze” was most pronounced from the BBC under Director-General Greg Dyke, with ITV taking the opportunity to follow the BBC –its nearest rival- in terms of low commission prices and high levels of retained rights.¹⁶

1.4.7. PSB and Indie Growth Have Probably Been Largely Complementary

UK indies today benefit from the range of programming commissioned by PSB broadcasters, and the relatively high schedule renewal rates across the UK’s channels. This leads to a wide range of tried and tested IP each year, the successful ones of which can then be developed for international format development.

The revenues and profits earned by the increasingly global indie sector, allow the indies to offer new commissions to the PSB broadcasters at competitive prices, and then accept relative modest price renewals thereafter, as they can either accept the lower margin on a UK commission or even a deficit that needs commissioning, in return for the global opportunities offered through rights retention.

This represents a virtuous circle of value development and risk sharing between the independent producer and the PSB broadcaster that has probably helped the UK TV sector drive global growth at a time of global economic recession, as overseas broadcasters seek to reduce their risks by adopting tried and tested ideas from the UK market rather than developing too much of their own IP.

¹⁶ Both the ITV Network Centre and BBC licence fee services stance on rights was at two levels, First, requiring a long exclusive window for showings on their own networks in the UK, for a price only just above cost, and then, offering to buy all remaining rights from the independent – such as UK secondary and overseas - with co-investment from BBC Worldwide or an ITV company rights distributor – an offer the independent producer was keen to accept as the only way of making a reasonable profit from the programme.